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SUBJECT: EL SALVADOR'S SHORT-TERM DEBT MARKET RETURNING TO NORMAL

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¶1. (SBU) SUMMARY. Salvadoran banks have rolled over short-term government debt due in February and March and committed to doing the same with debt due in May and June. However, with tax revenue falling and an international loan falling through, the government will also likely need to issue additional debt. El Salvador's short-term debt market is nearly back to normal, just three months after coming to the brink of default (reftel). Underlying problems including untargeted subsidies and overreliance on short-term financing will fall to the next government to address. END SUMMARY.

¶2. (SBU) Manuel Rosales, Director of Finance and Public Credit Policy, Ministry of Finance, told Econoff on March 20 that the Government of El Salvador (GOES) had successfully rolled over its February and March short-term debt (Letters of Treasury, commonly called "Letes"). El Salvador's four largest banks, Banco Agricola (owned by BanColombia), Citibank, HSBC, and ScotiaBank, had all agreed to roll over their holdings, laddering their portfolios with one-year, nine-month, and six-month maturity Letes. In addition, Rosales reported that Banco Agricola had promised to roll over the "small amount" of Letes maturing in May and June. Rosales added that the banks had indicated they would also roll over any new Letes coming due this year.

¶3. (U) Tax revenues, however, have fallen rapidly as El Salvador's economy has slowed down. According to Central Bank statistics, total tax collection in January 2009 fell 12 percent compared to January 2008. Value-Added Tax (IVA) revenues fell 25 percent compared to January 2009 and import tariff revenue fell 32 percent in the same period.

¶4. (SBU) With less revenue coming in, Rosales said the GOES would need to issue new Letes to cover its budget shortfall. The GOES had expected an additional $150 million from the Central American Bank for Economic Integration (CABEI), but, according to Rosales, CABEI was now "short of funds." Therefore, the GOES would resume its public offerings of Letes, suspended since October, with an approximately $10 million auction the week of March 23. Rosales said that they expected the banks and pension funds to buy most of the offering.

¶5. (SBU) COMMENT: El Salvador's short-term debt market is almost back to normal just three months after the GOES was at the brink of default. While the short-term crisis has been averted, the underlying fiscal issues still need to be addressed, including the GOES's costly, untargeted energy subsidies and its overreliance on short-term debt to fund medium and long-term expenditures. Uncertainties about the economic policies of President-Elect Mauricio Funes (who will not take office until June 1), lower remittances and the worldwide economic slowdown will also reduce investment, consumer purchases and government revenues. It will fall to the incoming Funes government to address these challenges, only some of which will be within its control. END COMMENT.

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